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U. S.
FILED
DEC 29 1943
CHARLES ELMORE CROPLEY
CLERK.

Supreme Court of the United States

OCTOBER TERM, 1943.

No. 563

EMPIRE TRUST COMPANY, as Trustee under Indentures securing debentures of ASSOCIATED GAS AND ELECTRIC CORPORATION, due 1973,

Petitioner,

vs.

DENIS J. DRISCOLL and WILLARD L. THORP, as Trustees of ASSOCIATED GAS AND ELECTRIC CORPORATION, Debtor.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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Debtor.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner respectfully prays that this Court issue a writ of certiorari to review, to the extent that it modified the decree of the District Court, a final decree, dated September 29, 1943, made by the United States Circuit Court of Appeals for the Second Circuit, hereinafter more fully described.

A.

Statement.

The following is a short statement of the matter involved which will also serve as a statement of the case for the purposes of the brief annexed to this petition.

Certain individuals conducted business as unincorporated associations under the assumed names of Transfer and Coupon Paying Agency (Traco) and Transfer and Paying Agency (Trapa) (R. 459-460). Under these assumed names, they maintained certain special accounts at certain New York banks (R. 462-463). During the years 1932-1939, Associated Gas and Electric Corporation (Agecorp) caused more than $141,000,000 of interest to be paid into and disbursed from these special accounts to holders of its debentures (R. 491, 486-487). The procedure was as follows.

At each accrual of interest during the years 1932-1939, Agecorp debited "Accrued Interest", credited "Special Deposits" and made the following typical journal record (R. 401, 484): "To record *liquidation** of 6 mos. interest due and payable 3/15/34 on our 3½'s of 1978 and 4's of 1973 * * *." Agecorp then prepared a voucher in "Favor of Transfer and Coupon Paying Agency—*Coupon Account*", or Traco's registered interest account as the case might be (R. 485). After January, 1937, these vouchers were drawn in "Favor of Transfer and Paying Agency *Coupon Account*" or Trapa's registered interest account as the case might be (R. 486). Each of these vouchers contained the "*Particulars*" of precisely calculated "*Funds needed to pay int. cpns.*" of specifically described debenture issues of Agecorp (R. 485).

Agecorp then in each case drew a check upon its *general* funds in an amount equal to the aggregate of the items described in each such voucher (R. 479, 486, 135-140). These checks were drawn to the order of and deposited in one of the Traco or Trapa *special accounts as such* (R. 479). Typical of the endorsements made on these checks was the

* Italics in all quotations herein are ours, unless otherwise indicated.

following (R. 479): "For deposit *only* to the account of Transfer and Coupon Paying Agency *Coupon Account.*"

Agecorp transmitted each of these checks to Traco or Trapa with letters of transmittal or memoranda describing the check as drawn to the order of the particular Traco or Trapa special account, together with a statement of its purpose, *e. g.: "To cover* Coupon Interest due December 1, 1939 on the following Associated Gas and Electric Corporation Debentures" (R. 480, 181). After these checks were deposited, the Traco or Trapa special account to the order of which they were drawn—not Traco or Trapa—drew and distributed checks for the payment of coupon and registered interest on Agecorp's debentures (R. 487).

On November 8, 1934, Agecorp sent Traco two letters (R. 482-483). The first concerned funds theretofore transmitted for the payment of interest as set forth above. Agecorp therein stated: "This is to advise you that any amount of such deposits remaining with you are to be held *in trust* by you for the holders of such securities to whom the interest is payable, for a period of *one year* from the date hereof." The second concerned funds therewith transmitted for the payment of interest as set forth above, and contained similar instructions.

Thereafter, until January, 1937, Agecorp continued to cause funds to be deposited in Traco's special accounts for the payment of interest as set forth above, accompanied by the book records, vouchers, checks and letters of transmittal described above. In January, 1937, the undisbursed balances in Traco's special accounts were taken over into the Trapa special accounts (R. 462, 191). Thereafter undisbursed and subsequently accrued interest on Agecorp's debentures was paid out of the Trapa special accounts (R. 463). The procedures described above remained unchanged

and continued except for the substitution of the Trapa special accounts for the Traco special accounts as the instrumentality of receipt, segregation and disbursement (R. 463).

After the letters of November 8, 1934, no part of the undisbursed balances in the Traco-Trapa special accounts was ever demanded or received by Agecorp (R. 491-492, 402). Agecorp continued in all respects to treat those undisbursed balances as beyond its control and as specifically appropriated for the particular purpose of paying interest on its debentures (R. 161, 594).

Agecorp's balance sheet treatment of these funds in the years 1932 to 1939 indicated its consistent intention and representation that the funds in question had been specifically appropriated for the purpose of paying interest on its debentures (R. 406-415). Similarly, detailed and *audited* adjustments between Agecorp and the Traco-Trapa special accounts pursuant to which deficiencies in or overpayments of interest were cured, indicated Agecorp's intent to relinquish control over the funds in question (R. 481, 293, 556).

Agecorp's accountant testified that these funds were appropriated for the particular purpose of paying interest on Agecorp's debentures and segregating them from Agecorp's general cash (R. 401, 161). Trapa's vice-president testified that Ageco paid Traco and Trapa for their services; that these payments were deposited in the *general* bank accounts of Traco and Trapa as such; and that Traco and Trapa as such never commingled their *general* funds with the funds in these special accounts for the payment of interest (R. 488-89, 159-160, 182). Agecorp maintained large accounts of its own *general* funds in the very same

banks in which the Traco and Trapa special accounts were maintained (R. 488).

In February, 1940, after Agecorp's Chapter X trustees had been appointed and after all payments of interest had ceased, the undisbursed balances in the Trapa special accounts were subjected to the tax lien of a jeopardy assessment filed by the Internal Revenue Department. To procure the release of the special accounts from the tax lien, Agecorp caused an *affidavit* to be filed with the Department of Internal Revenue (R. 489-90, 266-69). Agecorp's treasurer therein stated under oath that Trapa "has no rightful claim to any part of the said funds and does not make any such claim" (R. 269). He therein further stated that: "This affidavit is made in order that the notices of tax liens * * * may be vacated * * * *so that said funds may be available for the purposes for which they were originally deposited*" (R. 269).

Those "purposes" were the payment of interest on Agecorp's debentures. Those "purposes" could not have been the re-absorption of the funds by the Chapter X trustees of Agecorp which was then in bankruptcy. In reliance on that affidavit and a similar affidavit made by Trapa's treasurer (R. 258), the Collector of Internal Revenue released the funds from the tax lien of the jeopardy assessment because they were "*funds deposited by the corporations listed above with said taxpayer [Trapa] for the purpose of paying* their security holders interest and dividends when due" (R. 275, 276, 278, 279). The last release from the tax lien was made on February 17, 1941 (R. 276). On March 6, 1941, Trapa assigned these funds—the undisbursed balances in the special accounts which then aggregated $192,550.65—to Agecorp's Chapter X trustees

subject to determination of the outstanding claims of third parties (R. 503).

The Special Master reported that, for various reasons including the procedures described at pages 2-5, *supra*, these funds were affected by a *"trust status"* in favor of holders of Agecorp debentures for the payment of coupon and registered interest, and that they could not be reabsorbed by Agecorp's Chapter X trustees (R. 377-386; 400-422). The District Court confirmed the Special Master's report, but on narrower grounds (R. 593-595). The Circuit Court of Appeals modified the determination of the District Court. It held that the funds in the Traco special accounts had been affected by a one year trust under the letters of November 8, 1934; that such trust terminated after the expiration of one year; and that the funds received by Trapa from Agecorp, including the undisbursed balances transferred from the Traco special accounts into the Trapa special accounts, were not affected by a "trust" (R. 657-664).

At all its stages, the case was affected by confusion between the rigid requirements of an *inter vivos* trust proper and the trust *status* of a bailment arising from a specific appropriation of specifically described property to a specific purpose.

B.

The Questions Presented.

Did the Circuit Court of Appeals for the Second Circuit err in:

1. Failing to follow the law applicable to this case as set forth by the Supreme Court of the United

States in *McKee* v. *Lamon,* 159 U. S. 317, in terms of the principle that (p. 322): "The acceptance of the money *with notice of its ultimate destination* is sufficient to create a duty on the part of the *bailee to devote it to the purposes intended by the bailor*"?

2. Failing to follow the law applicable to this case as set forth by the Court of Appeals of New York in substantially the same terms in *People etc.* v. *The City Bank of Rochester,* 96 N. Y. 32, 36-37; *Shawmut Corp.* v. *Bobrick Sales Corp.,* 260 N. Y. 499, 504, *et seq.;* and *Sayer* v. *Wynkoop,* 248 N. Y. 54, 58, 59-60, 63?

3. Construing the letters of November 8, 1934 as creating trusts having a one year time limitation despite the fact that under New York law a trust for one year or any other definite period of time is illegal?

4. Holding that the transfer in 1937 of the undisbursed balances in the Traco special accounts to the Trapa special accounts—a mere change of bailee—affected the nature of the bailment with respect to those funds and funds thereafter transmitted to the Trapa special accounts?

5. Holding that Trapa was merely "a new paying agent", and failing to hold that the agency of Traco and then Trapa to pay on behalf of Agecorp was coupled with another agency, *i. e.,* an irrevocable bailment to Traco and then Trapa, as bailee, of the funds to be paid out on behalf of Agecorp, the bailor?

C.

Reasons Relied on for Granting the Writ.

1. The Second Circuit Court of Appeals has in this case decided important questions of New York law of bailment in probable conflict with the applicable decisions of this

Court and of the Court of Appeals of New York (*McKee* v. *Lamon*, 159 U. S. 317, 322; *People etc.* v. *The City Bank of Rochester*, 96 N. Y. 32, 36-37; *Shawmut Corp.* v. *Bobrick Sales Corp.*, 260 N. Y. 499, 504, *et seq.*; *Sayer* v. *Wynkoop*, 248 N. Y. 54, 58, 59-60, 63).

2. Unless this Court takes occasion to review an erroneous determination, as in this case, of important state law, the principle that state law should be followed in the federal jurisdiction (*Federal Judiciary Act of Sept. 24, 1789*, c. 20, §34, 28 U. S. C. A. §725) will be as much undermined by erroneous application of state law as it formerly was by federal departure from state law under the "doctrine of *Swift* v. *Tyson*" (*Erie R. Co.* v. *Tompkins*, 304 U. S. 69).

3. The law governing the disposition of funds deposited by foreign corporations, municipalities and states with agents in New York for the payment of interest on securities of such parties affects large sums, a great number of public investors throughout the nation, and is especially important in the City and State of New York where financial services of that nature are centered.

WHEREFORE, petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Second Circuit in the case entitled "*In the Matter of Associated Gas and Electric Corporation, Debtor, Denis J. Driscoll, et al., etc., Appellants*, v. *Empire Trust Company et al., etc., Appellees*", No. 302, October Term, 1942, on the docket of said Court, to the end that the decree made by that Court, dated September 29, 1942, in so far as it modified the decree of the District Court in that case, may be reviewed and reversed by this Court, and that

petitioner may have such other and further relief in the premises as this Court may deem proper and just.

Dated, New York, N. Y., December 28, 1943.

EMPIRE TRUST COMPANY, as Trustee under Indentures securing debentures of Associated Gas and Electric Corporation, due 1973.

By JOSEPH GLASS,
Counsel for Petitioner.